

Guinness Best of China Fund

INVESTMENT COMMENTARY – February 2019

Launch date	15.12.15		
Team	Edmund Harriss (manager) Mark Hammonds (analyst) Sharukh Malik (analyst)		
Aim	Guinness Best of China Fund is designed to provide investors with exposure to economic expansion and demographic trends in China and Taiwan. The Fund is managed for capital growth and invests in profitable companies generating persistently high return on capital over the business cycle.		
Performance	31.01.19		
Fund	Best of China Fund		
Index	MSCI Golden Dragon		
Sector	IA China/Greater China		
	1 year	3 years	From launch
Fund	-15.4	56.7	48.3
Index	-9.2	67.6	64.3
Sector	-13.2	62.0	52.6
Annualised % total return from launch (GBP)			
Fund	13.4%		
Index	17.2%		
Sector	14.4%		
Risk analysis (annualised, weekly, from launch)			
	Index	Sector	Fund
Alpha	0.0	-2.4	-3.0
Beta	1.0	1.0	1.0
Info ratio	0.0	-0.6	-0.6
Max drwn	-17.8	-21.7	-25.7
Tracking err	0	5	6
Volatility	18.6	18.8	19.1
Sharpe ratio	0.7	0.5	0.4
Past performance should not be taken as an indicator of future performance. The value of this investment and any income arising from it can fall as well as rise as a result of market and currency fluctuations.			
Source: Financial Express, bid to bid, total return 0.74% OCF. Returns for share classes with a different OCF will vary accordingly			

Fund & Market

- In January, the Best of China Fund rose 6.6% (in GBP, Z class) while the MSCI Golden Dragon Net Total Return Index rose 4.9%.
- Chinese stocks were notably strong, rising 7.9% compared to 4.7% for Hong Kong and -1.2% for Taiwan. Stronger Chinese markets were likely driven in part by continued talks between China and America over the trade dispute. American delegates met with their counterparts in Beijing which was followed by another meeting in Washington led by Liu He. The two sides have until March 1st to reach a deal, otherwise tariffs on \$200bn of imports to the US from China will be increased from 10% to 25%.
- The strongest sectors in China were Consumer Discretionary (+15.9%), Real Estate (+12.4%) and Health Care (+11.5%). Policymakers announced plans to stimulate consumption of white goods by subsidising purchases of environmentally friendly appliances. New policies were announced for the automobile sector, encouraging replacement of older, less fuel-efficient cars, although specific details were absent. The VAT rate applied to transactions was also lowered from 3% to 2%.
- Taiwan was weak mainly because of Apple's cut in guidance, and many stocks with significant exposure to Apple lagged. The fund is underweight in Taiwan, which helped, but it was primarily individual stocks which contributed to performance. Elite Material and Novatek Microelectronics were much stronger than the local market; neither has significant exposure to Apple.

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- A combination of a more dovish outlook by the Federal Reserve in the US and stabilising property prices helped explain the strong performance of Real Estate in Hong Kong (+10.4%).
- The strongest stocks in the portfolio were New Oriental Education (+36.5%), Tongda Group (+31.8%) and Sino Biopharmaceutical (+24.0%).
- The weakest stocks in the portfolio were Qualcomm (-15.5%), Autohome (-10.1%) and Geely (-6.8%).

Events in January

- Monetary policy was loosened further in China. The required reserve ratio (RRR) was cut by one percentage point. The aim, as ever, is to channel this liquidity towards small and medium enterprises and away from speculative uses.
- In a form of fiscal loosening, the government cut taxes for small businesses. The corporate tax rate for businesses with less than one million yuan in taxable earnings will fall to five percent, and for those with taxable earnings between one and three million, the rate will fall to 10%.
- Financial access to foreign firms continued to increase. S&P became the first foreign company to receive approval to operate a domestic bond business in China. JPM Asset Management received approval to sell two funds in China, through its local joint venture.
- Bloomberg announced it would be adding renminbi government debt into the Bloomberg Barclays Global Aggregate Index from April 2019 onwards. The process will be implemented over 20 months, and when fully accounted for, Chinese bonds will represent the fourth largest currency in the index.
- The pushback against Huawei continued. American prosecutors charged Huawei with a dozen indictments including fraud, conspiracy, theft of trade secrets and obstruction of justice. Reports indicate more Western economies are considering excluding Huawei from the buildout of 5G.

Portfolio Update

New Oriental Education provides after-school tuition services in China. The business has been affected by new regulations introduced in 2018 covering the entire industry. One of the more important changes was that tuition providers could no longer collect prepayments longer than three months, limiting the float of the business. The other rules aim to standardise the industry – for example, there are rules on what can and cannot be taught, and licensing is required to open a centre. In our opinion, the regulations were designed to weed out more unsophisticated centres rather than professional and larger entities like New Oriental. Nevertheless, as one of our holdings trading at relatively higher valuations, the combination of tighter regulation and weaker markets meant the earnings multiple fell over the course of 2018. However, it seems New Oriental is managing well and it reported results which beat expectations on both a revenue

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and earnings basis. It is one of the faster-growing companies in the portfolio, with earnings expected to increase by roughly 20% over the next few years.

Tongda Group is most known for its metal casings for smartphones but has diversified into plastic cases that look like glass (known as 'glasstic'). The Chinese smartphone market was weak over the course of 2018 and with Tongda targeting 40% volume growth, the market was questioning whether this was too ambitious. Tongda put out an update confirming it had become a supplier for Samsung in the third quarter of last year. So far, Tongda has been supplying glasstic back covers for a low-end model and it is looking to supply mid-range models. According to Canalys, Samsung shipped 294m phones in 2018 and 317m in 2017, so if Tongda were to take a reasonable share of these shipments its volume target looks more reasonable. The company also announced its expansion into base station antenna for 5G, expecting production to commence in the second quarter.

Autohome was weak following its decision to increase prices for lead generation by at least 20%, with some reports indicating leading dealers stopped dealing with Autohome as a result. Management confirmed most clients have already paid for their 2019 services so in the short term, earnings look relatively safe. Dealers are finding it tough in the weak auto environment and understandably a 20% price hike is not helpful – although on this front Autohome seem to be flexible. Following a meeting with some of its clients it is considering increasing the number of guaranteed leads and discounting services during Chinese New Year promotional events. We continue to keep an eye on proceedings and expect a compromise to be reached. Dealers spend up to half of their marketing budgets online and Autohome will account for a significant portion. Its leading position in the industry means it has pricing power and this is why we like the company.

Approvals for gaming monetisation resumed at the end of December. Although Netease and Tencent were not included in the first batch of approvals, they were included in the second and this should provide support for earnings over the coming year. Note that the two firms are the largest gaming companies in China.

Summary view & outlook

We expect the fund's focus on companies persistently earning a return on capital well above the cost of capital to serve it well in the long term. The fund now trades on a price to earnings multiple of 10.0x based on estimated 2019 earnings, while its discount to the benchmark is 20%. Our companies earn well above the cost of capital; in 2017 the overall real return on capital (which excludes the effects of inflation) for the fund's holdings was 14.8%. This is expected to be only marginally lower for 2018, at 14.4%, which is comforting in a weakening macro environment. Our confidence in the future is based upon sustained profitability over many years, covering the post financial crisis stimulus, numerous housing cycles, the four-year period of falling producer prices 2011-15, the mainland stock market bubble, and the current slowdown.

Edmund Harriss (portfolio manager)

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Sharukh Malik (analyst)

Data sources

Fund performance: *Financial Express*, total return
0.74% OCF in GBP

Index and stock data: *Bloomberg*

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Guinness Best of China Fund

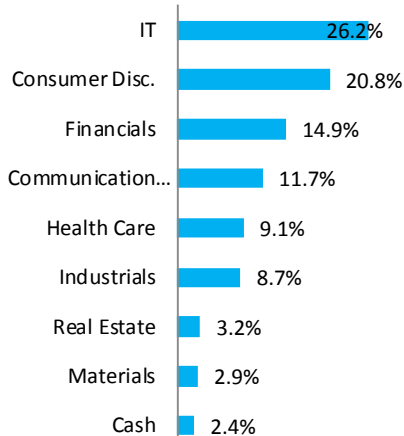
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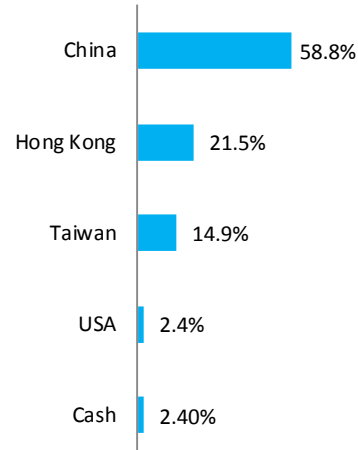
Fund top 10 holdings

Tongda Group Holdings	3.4%
China Overseas Land	3.2%
Sino Biopharmaceutical	3.2%
Tencent Holdings	3.2%
Li & Fung	3.1%
China Lilang	3.1%
Yangzijiang Shipbuilding	3.1%
Novatek Microelectronics	3.1%
Luk Fook Holdings	3.1%
Noah Holdings	3.1%
% of Fund in top 10	31.6%
Total number of stocks	34

Sector analysis



Geographic allocation



PERFORMANCE

31/01/2019

Annualised % total return from launch (GBP)

Fund	13.4%
MSCI Golden Dragon Index	17.2%
IA China/Greater China sector average	14.4%

Discrete years % total return (GBP)

	Jan '15	Jan '16	Jan '17	Jan '18	Jan '19
Fund	-	-	39.8	32.5	-15.4
MSCI Golden Dragon Index	28.0	-14.1	40.6	31.2	-9.2
IA China/Greater China sector average	20.3	-13.2	37.8	35.5	-13.2

Cumulative % total return (GBP)

	1 month	Year-to-date	1 year	3 years	5 years	From launch
Fund	6.6	6.6	-15.4	56.7	-	48.3
MSCI Golden Dragon Index	4.9	4.9	-9.2	67.6	84.4	64.3
IA China/Greater China sector average	5.8	5.8	-13.2	62.0	69.2	52.6

RISK ANALYSIS

31/01/2019

Annualised, weekly, from launch on 15.12.15, in GBP	Index	Sector	Fund
Alpha	0.00	-2.39	-3.01
Beta	1.00	0.98	0.97
Information ratio	0.00	-0.60	-0.58
Maximum drawdown	-17.78	-21.67	-25.74
R squared	1.00	0.94	0.90
Sharpe ratio	0.67	0.49	0.44
Tracking error	0.00	4.65	6.06
Volatility	18.62	18.77	19.10

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Source: Financial Express, bid to bid, total return (0.74% OCF). Fund launch date: 15.12.2015.

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Important information

Issued by Guinness Asset Management Limited, authorised and regulated by the Financial Conduct Authority.

This report is primarily designed to inform you about Guinness Best of China Fund. It may provide information about the Fund's portfolio, including recent activity and performance. It contains facts relating to the equity markets and our own interpretation. Any investment decision should take account of the subjectivity of the comments contained in the report.

This document is provided for information only and all the information contained in it is believed to be reliable but may be inaccurate or incomplete; any opinions stated are honestly held at the time of writing, but are not guaranteed. The contents of the document should not therefore be relied upon. It should not be taken as a recommendation to make an investment in the Fund or to buy or sell individual securities, nor does it constitute an offer for sale.

Risk

The Guinness Best of China Fund is an equity fund. Investors should be willing and able to assume the risks of equity investing. The value of an investment and the income from it can fall as well as rise as a result of market and currency movement, and you may not get back the amount originally invested. Details on the risk factors are included in the Fund's documentation, available on our website. Shareholders should note that all or part of the fees and expenses will be charged to the capital of the Fund. This will have the effect of lowering the capital value of your investment.

Documentation

The documentation needed to make an investment, including the Prospectus, the Key Investor Information Document (KIID) and the Application Form, is available from the website www.guinnessfunds.com, or free of charge from:-

- the Manager Link Fund Manager Solutions (Ireland) Ltd, 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland; or,

- the Promoter and Investment Manager: Guinness Asset Management Ltd, 14 Queen Anne's Gate, London SW1H 9AA.

Residency

In countries where the Fund is not registered for sale or in any other circumstances where its distribution is not authorised or is unlawful, the Fund should not be distributed to resident Retail Clients.

NOTE: THIS INVESTMENT IS NOT FOR SALE TO U.S. PERSONS.

Structure & regulation

The Fund is a sub-fund of Guinness Asset Management Funds PLC (the "Company"), an open-ended umbrella-type investment company, incorporated in Ireland and authorised and supervised by the Central Bank of Ireland, which operates under EU legislation. If you are in any doubt about the suitability of investing in this Fund, please consult your investment or other professional adviser.

Switzerland

The prospectus and KIID for Switzerland, the articles of association, and the annual and semi-annual reports can be obtained free of charge from the representative in Switzerland, Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva, Switzerland, Tel. +41 22 705 11 77, www.carnegie-fund-services.ch. The paying agent is Banque Cantonale de Genève, 17 Quai de l'Ile, 1204 Geneva, Switzerland.

Singapore

The Fund is not authorised or recognised by the Monetary Authority of Singapore ("MAS") and shares are not allowed to be offered to the retail public. The Fund is registered with the MAS as a Restricted Foreign Scheme. Shares of the Fund may only be offered to institutional and accredited investors (as defined in the Securities and Futures Act (Cap.289)) ('SFA') and this material is limited to the investors in those categories

Telephone calls will be recorded and monitored.

GUINNESS

ASSET MANAGEMENT

Guinness Asset Management Ltd is authorised and regulated by the Financial Conduct Authority

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